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IN THE

Supreme Court of the United States

October Term, 1940.

No. 120.

HOWARD S. PALMER, JAMES LEE LOOMIS and HENRY B. SAWYER, Trustees of the property of The New York, New Haven and Hartford Railroad Company, Debtor,

Petitioners,

v.

WEBSTER AND ATLAS NATIONAL BANK OF BOSTON, Trustee,

Respondent.

BRIEF FOR PETITIONERS.

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Petitioners,

v.

WEBSTER AND ATLAS NATIONAL BANK OF BOSTON, Trustee,

Respondent.

BRIEF FOR PETITIONERS.

Opinions Below.

The District Court's opinion (R., pp. 12-19), which is not officially reported, is in the record at pages 12-19. The opinion of the Circuit Court of Appeals (R., pp. 185-196) is reported at 111 F. (2d) 215, sub. nom. *Webster and Atlas Nat. Bank of Boston* v. *Palmer, et al.*

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 16, 1940 (R., p. 197, fol. 589). Jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 347).

Questions Presented.

1. Whether or not the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a), hereinafter referred to as "Sec. 124a", requires the trustees of the property of a bankrupt lessee railroad company, operating the property of a bankrupt lessor railroad company under Section 77(c)(6) of the Bankruptcy Act (11 U. S. C. A., Sec. 205(c)(6)), hereinafter referred to as "Sec. 77(c)(6)", for the account of the lessor's estate after rejection of the lease, to advance cash out of funds in the estate of the lessee for payment of taxes of a terminal company for which only the terminal company and the lessor are made liable by State law, the payment of such taxes not being immediately necessary to the continued operation of the lessor's property and there being no funds or other property of the lessor from which such taxes can be paid or from which the cash advanced can be recollected.

2. Whether or not Section 65 of the Judicial Code (28 U. S. C. A., Sec. 124), hereinafter referred to as "Sec. 124", requires the same trustees to advance cash for payment of interest on the terminal company's bonds, the other circumstances being the same.

3. Whether or not affirmative answers to the foregoing questions violate the Fifth Amendment to the Constitution of the United States.

Statutes Involved.

The statutes involved are the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a), Sec. 65 of the Judicial Code (28 U. S. C. A., Sec. 124) and Sec. 77 of the Bankruptcy Act (11 U. S. C. A., Sec. 205). The first two Acts and the applicable portion of the third are set forth in the Appendix.

Statement.

In 1888 the Boston and Providence Railroad Corporation let its property to the Old Colony Railroad Company for a term of 99 years (R., pp. 129-143); and in 1893 the Old Colony let its property, including its leasehold interest in the Boston and Providence property, to The New York, New Haven and Hartford Railroad Company, also for a term of 99 years (R., pp. 72-80). At that time the City of Boston was served by the railroad lines of the two lessors and of the New England Railroad Company and the Boston and Albany Railroad Company. After the lease of 1893, the properties of the two lessors were operated by the New Haven as parts of its railroad system.

In 1896, after both leases had been executed, The Boston Terminal Company was incorporated by an Act of the Massachusetts legislature (Massachusetts Acts and Resolves, 1896, Ch. 516)[1] to provide a union station for passengers on railroads entering the southerly part of the City of Boston. That Act required the Boston and Albany, the New England and the two lessors, whose properties served the area, to use the terminal for all their terminal passenger business in Boston (Secs. 2, 9) and to pay the amounts necessary to cover the Terminal Company's expenses, including its taxes and bond interest, in proportion to their use of its facilities (Sec. 10). The requirements of use and payment were also laid upon the New Haven, but were limited to its use of the terminal as lessee of the Old Colony—it owned no property serving Boston.[2]

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[1] The applicable portions of the Act are set forth in the Appendix.

[2] The four other railroads are named as such in the Act, but the New Haven is described as ". . . the New York, New Haven and Hartford Railroad Company, being lessee of the Old Colony Railroad Company" (Sec. 2).

And later when the Boston and Albany let its property to the New York Central, the Act was amended so as to include the latter, also as "lessee" (Massachusetts Acts, 1921, Ch. 363). In the meantime the New England had been merged into the New Haven (R., p. 16, fol. 46; Massachusetts Acts and Resolves, 1905, Ch. 252; Rhode Island Acts and Resolves, 1915, p. 452, Sec. 4). Thus the New Haven and the New York Central became the only users of the terminal, all other companies enumerated in Section 2 of the charter having been leased or merged. There was no use of the terminal over the former New England line for the period here involved (R., p. 16).

Upon approval on October 23, 1935, of the petition of the New Haven for reorganization there came into the custody of the District Court, as a part of the system of lines operated by the New Haven, the lines of the Old Colony and the Boston and Providence. Continued operation of the system was provided for (R., pp. 44-52) and trustees were appointed (R., pp. 53-56). Both the Old Colony and the Boston and Providence leases have been rejected (R., pp. 66, 113) and the New Haven Trustees have continued to operate both lines for the account of the former lessors under orders so providing (*Palmer* v. *Palmer*, 104 F. (2d) 161, C. C. A. 2d, 1939, cert. den. 308 U. S. 590 [1939]; *Palmer* v. *Warren*, 108 F. (2d) 164, C. C. A. 2d, 1940, affd. sub. nom. *Warren* v. *Palmer*, 310 U. S. 132 [1940]; R., p. 69, fol. 206; p. 72, fol. 214; pp. 81-82, fols. 242-244; p. 87, fol. 260; p. 92, fol. 276; p. 112, fol. 335), pursuant to Sec. 77(c)(6) (R., p. 186, fols. 557, 558).[3] In 1931 the Department of Public

[3] The District Court entered its order approving Old Colony's petition for reorganization in the New Haven proceedings on June 3, 1936 (R., pp. 81-83). The Boston and Providence has been in reorganization under Sec. 77 since August 5, 1938, in the District Court of the United States for the District of Massachusetts (R., pp. 126-128).

Utilities of Massachusetts determined under Section 10 of the Act the proportion of use of the terminal at seventy per cent. for the lines operated by the New Haven (including the Old Colony and Boston and Providence) and thirty per cent. for the line operated by the New York Central (Boston and Albany) (R., p. 155, fol. 465). No reapportionment has been made since that time. The accounting for these operations by the New Haven trustees required by Sec. 77(c)(6) has been accomplished by means of a segregation of expenses and revenues approved by the Interstate Commerce Commission (R., p. 95, and see Sec. 77(c)(10)) and by the District Court (R., p. 96) and confirmed in *Palmer* v. *Palmer, supra.* In said accounting the aforesaid 70% is charged to Old Colony and Boston and Providence operations in proportion to use (R., p. 10, fol. 28).

The operations by the New Haven Trustees of the two lines formerly leased to the New Haven have resulted in a large deficit. Indeed, losses incurred in the operation of Old Colony and Boston and Providence properties exceeded $20,000,000 for the period from October 23, 1935, to and including December 31, 1939 (R., p. 13, fol. 37; p. 37, fol. 109; and see R., pp. 97-107, 114-122, 144-153). Payments by the New Haven Trustees of bond interest and taxes of the Terminal Company were swelling the steadily mounting advances of cash from the New Haven estate for the account of Old Colony and Boston and Providence at a rate of approximately $800,000 per year (R., p. 6, fol. 18; p. 7, fol. 21; pp. 9, 10, fols. 27, 28; p. 32, fols. 95, 96) and it became apparent not only that the properties of the two lessors were not sufficient security to warrant the diversion of additional cash from the New Haven estate without jeopardy to the New Haven's own creditors (R., p. 187, fol. 560), but that recovery of amounts already advanced was doubtful.

Accordingly, the New Haven Trustees filed a petition on October 19, 1939, stating that in their opinion they should make no further advances of cash for payment of Boston Terminal taxes and bond interest for the account of Old Colony and Boston and Providence estates (R., p. 10, par. 7). At the hearing on this petition there were represented, besides petitioners, Old Colony Railroad Company, the trustee of the mortgage securing the bonds of that Company, a protective committee of its shareholders, a group of insurance company holders of New Haven bonds, a group of mutual savings banks holding New Haven and Old Colony bonds, two trustees under mortgages securing issues of New Haven bonds, a protective committee of holders of underlying New Haven bonds, the Commonwealth of Massachusetts, the City of Boston, and the predecessor of respondent (R., pp. 24, 25). The District Court, after hearing, issued its opinion (R., pp. 12-19) and entered its order (No. 398) directing that the New Haven trustees should withhold the payments (R., p. 20).[4] The predecessor of respondent, trustee under the mortgage securing the bonds of the Terminal Company, was the only one who appealed the decision. The Circuit Court of Appeals reversed because it construed Sec. 124a, Sec. 124 and Sec. 77(c)(6) as requiring these payments to be continued (R., pp. 193-196), despite the fact they were not immediately necessary to continued operation of the Old Colony and Boston and Providence properties (R., p. 192, fol. 575; p. 17, fol. 50) and despite the further fact that as the Circuit Court said, "It has become apparent that the prior lien af-

[4] On petition of holders of bonds of the Terminal Company filed November 3, 1939, proceedings for its reorganization under Sec. 77 of the Bankruptcy Act were instituted in the United States District Court for the District of Massachusetts (Docket No. 63870).

forded the New Haven is not sufficient security to warrant the diversion of additional funds, "without jeopardy to the claims of the New Haven's own secured creditors" (R., p. 187, fol. 560. See also pp. 193-194, fols. 579, 580; p. 196, fol. 587; p. 13, fol. 38).

The decision turns on Secs. 124a and 124, which sections were not argued before the Court of Appeals. That Court's construction of these sections was urged upon it not by the appellants (who did not even cite them), but by counsel for the City of Boston in a brief *amicus curiae* offered just before argument. Petitioners opposed the filing of this brief because the City, although appearing in the trial court, had failed to appeal. They asked opportunity to reply should the brief be received. The Court denied this request, but reserved ruling on acceptance of the brief and did not announce such ruling until decision of the case.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In reversing the order of the District Court.

(2) In holding that petitioners must advance cash to the estates of the Old Colony and Boston and Providence for payment of taxes and bond interest of The Boston Terminal Company.

(3) In so construing and applying Sec. 124a, Sec. 124 and Sec. 77(c)(6) as to require petitioners to advance cash for payment of said taxes and interest out of funds in the New Haven estate.

(4) In holding that its said construction and application of said statutes did not violate the Fifth Amendment to the Constitution of the United States.

(5) In violating said amendment by requiring petitioners to advance cash for payment of said taxes and interest out of funds in the New Haven estate.

Summary of Argument.

The essential point is that petitioners may not be compelled to pay out of the New Haven estate taxes and bond interest of the Terminal Company for which neither the New Haven nor petitioners as trustees of its property are liable by State law. The court below held that petitioners must do this, although the operations into the terminal are not in any sense New Haven operations, but are operations required for the account of Old Colony and Boston and Providence whose properties are being operated by petitioners under Sec. 77(c)(6) following rejection of the Old Colony lease.

The court below rested its decision squarely on Sec. 124a and Sec. 124. The first named section does not by its terms apply to petitioners in their situation here. Moreover, the general purpose of that section is to subject properties such as those of Old Colony and Boston and Providence to applicable State laws respecting taxes despite the appointment of federal receivers or trustees. The purpose of the latter section is to assure that physical operation of property shall be in accordance with the applicable State laws. Nothing in either section shows any intention to extend State laws beyond their stated scope so as to reach cash in another (the New Haven) estate of

which petitioners happen to be trustees, and use it to discharge the liabilities of the Old Colony and Boston and Providence whose cash and credit are insufficient to meet their own obligations. The fact that the funds of these two estates are insufficient to pay their debts does not require petitioners to dip into another estate to pay them, where immediate payment is not necessary to operation.

Petitioners are currently paying all expenses necessary to operate Old Colony and Boston and Providence properties into the terminal under Sec. 77(c)(6). The payment of the taxes and bond interest are not necessary to such operations and nothing in Sec. 77(c)(6) requires petitioners to pay them. Our case might rest here.

However, even if the New Haven corporation had been made liable by State law for the payment of bond interest after termination of the lease—even if it had guaranteed the payment of such interest—the obligation of the New Haven corporation to pay it would give rise merely to a general claim against the New Haven in its reorganization proceedings. To discharge it now in cash would be to prefer Terminal Company bondholders over the New Haven's secured and general creditors and interfere *pro tanto* with the exercise of Federal equity and bankruptcy powers upon which the reorganization of railroads is based. Nothing in Sec. 124 requires or justifies such an interference.

The holding of the court below that petitioners must pay Terminal Company taxes and bond interest out of cash in the New Haven estate violates the due process clause of the Fifth Amendment to the Constitution of the United States.

The argument to follow may be summarized under four headings:

(1) Neither the New Haven nor petitioners, as trustees of its property, are using the terminal *as lessees* of the property of Old Colony, and therefore the Massachusetts Act of 1896 does not make them liable to the Terminal Company for its bond interest or taxes.

(2) Sec. 134a, whether considered alone or in conjunction with Sec. 77(c)(6), does not make cash in the New Haven estate available for the discharge of liabilities of Old Colony and Boston and Providence estates to the Terminal Company for the latter's taxes, the payment of which is not immediately necessary to continued operation of lines of the former lessors.

(3) Sec. 124, whether considered alone or in conjunction with Sec. 77(c)(6), does not make cash in the New Haven estate available for the discharge of indebtedness of Old Colony and Boston and Providence estates to the Terminal Company for the latter's bond interest, the payment of which is not immediately necessary to continued operation of the lines of the former lessors.

(4) The interpretation made by the court below of Secs. 124 and 124a taken in connection with Sec. 77(c)(6) violates the due process clause of the Fifth Amendment to the Constitution of the United States.

(5) The public interest is not involved here since continued operation of the property is not threatened and since the Commonwealth is not deprived of its right to payment of the taxes.

Argument.

(1) Neither the New Haven nor petitioners, as trustees of its property, are using the terminal as LESSEES *of the property of Old Colony, and therefore the Massachusetts Act of 1896 does not make them liable to the Terminal Company for its bond interest or taxes.*

A. Introductory.

The court below held that petitioners, as trustees of the property of the New Haven, were liable for Terminal Company bond interest and taxes whether or not "the provisions of the Massachusetts Act of 1896, imposing direct obligations on the New Haven 'being lessee' of the Old Colony, continue to bind the New Haven after it[5] had rejected the lease" (R., p. 196). Thus the opinion below has this curious result: Cash in the New Haven bankrupt estate may be reached for the payment of obligations of third persons *for which neither the New Haven nor its estate is made liable by State law.* We urge that a claimant to cash during reorganization must ordinarily prove first a liability of the bankrupt or its estate and, second, some compelling reason for present payment. We also urge, especially as to bond interest in this case, that the Terminal Company or its representatives would have no right to present payment even if liability of the New Haven corporation could be shown to exist under State law. We discuss the State law at this point in order that this Court may be fully advised as to its content, and also because

[5] This is an inaccurate use of language. Petitioners, not the New Haven, rejected the lease (R., p. 66, fol. 198).

the clear absence of any liability under that law will demonstrate the rough shod operation of the Circuit Court of Appeals' interpretation of the federal law involved in this case.

B. The Act imposed liability upon the New Haven only as lessee of Old Colony, and the lease has ended.

Section 9 of the Act required all "*said railroad companies*" to use the station "*for all of their terminal passenger business in Boston*",[6] and Section 10 provided that "Each of said railroad companies shall pay for such use of said station * * * in the proportion in which it has the use thereof, * * *". Section 25, in similar vein, required payment by "said railroad companies" of real estate taxes on property of the Terminal Company used by them, each "in the proportion in which it then [viz., at time of assessment] has the use" of the property. To be liable under the act as drawn, the company sought to be charged must be one of "said railroad companies" and must also be using the terminal. As 1939 bond interest and taxes are here in issue, it is necessary to apply the language of the statute to the facts existing in that year. Who were then included in the words "said railroad companies" using the terminal? The answer to this question is first given by Sec. 2 of the Act which listed the railroad companies originally involved.

That section named first, and without qualification, the four proprietary companies whose properties were to have a physical connection with the terminal—

[6] All italics are supplied.

viz., "the Boston and Albany Railroad Company, the New England Railroad Company, the Boston and Providence Railroad Corporation, the Old Colony Railroad Company". It then listed the New Haven with an important qualification—viz., "the New York, New Haven and Hartford Railroad Company, *being the lessee of the Old Colony Railroad Company*". If the intention had been to include the New Haven as such and without qualification, the words just italicized would have been omitted from the Act. The description of the New Haven as lessee is both significant and controlling. As the District Court stated:

> "The inference is clear that under the charter [the Act of 1896] it was not intended that the use made of the terminal by the Old Colony should be paid for once by the Old Colony and again by the New Haven, as lessee. Rather the inclusion of the New Haven as a participant was designed to fasten upon the New Haven the obligations imposed by the charter with respect to the use made of the terminal by the Old Colony and Boston and Providence *while the New Haven was under obligation as the lessee of these properties*" (R., p. 14, fol. 41).

The distinction between proprietary and leased lines under the Act was neither inadvertent nor unconsidered. On the contrary, a dual classification of "said railroad companies" was made deliberately in Section 2 when the Act was first passed in 1896. It was deliberately perpetuated in 1921 when, after the New York Central had leased the Boston and Albany, that section was amended to include the Central *as lessee*. The relation of lessees to the Act was incidental to its main object that the railroad companies whose lines were operated into the terminal should

use it and be liable for the charges. Lessees were obliged to make payment only because and while they were operating the proprietary lines which were required to use the facilities and to pay for such use. And if further support for this view is needed it may be found in Sec. 4 of the Act which provided that in case the Terminal Company mortgage was foreclosed with a resulting deficiency "said railroad companies" would be held liable to pay such deficiency, "having regard to the use which they *or their lessees* may have respectively had of the mortgaged property".

Petitioners, as trustees of the property of the New Haven have rejected the Old Colony lease under which the New Haven operated Old Colony and Boston and Providence properties before the commencement of its reorganization proceedings (R., p. 66), and the Circuit Court of Appeals has already pointed out in earlier litigation that "the [district] court has continued the original joint operation of a leased road under Sec. 77(c)(6), *after the lease has ended*" (*Palmer* v. *Palmer, supra*, 104 F. (2d) 161, 165; R., pp. 81, 82, par. 2; R., p. 87, par. 6). The New Haven is no longer "lessee of the Old Colony Railroad Company" under Sec. 2 of the Act of 1896 and no longer liable as such to the Terminal Company under its charter. In fact the New Haven corporation does not operate into or use the terminal in any way. The petitioners do, but only as they are required by Sec. 77(c)(6) to operate the Old Colony and Boston and Providence properties in the public interest and for the account of those former lessors, the latter being unable to operate. And the order of the Massachusetts Department of Public Utilities in 1931 (R., p. 155, fol. 465) did not even purport to fix a liability upon the New Haven; it merely fixed a proportion of

use as between the two lessee companies then using the terminal and quite properly left the matter of liability to Sec. 10 of the Act.

C. PETITIONERS ARE NOT, AND THEY NEVER WERE, LESSEES OF OLD COLONY. THEY DECLINED TO ADOPT THE LEASE AND ARE OPERATING TRAINS INTO THE TERMINAL, NOT IN BEHALF OF THE NEW HAVEN ESTATE, BUT FOR THE ACCOUNT OF THE ESTATES OF OLD COLONY AND BOSTON AND PROVIDENCE.

Certainly petitioners, as trustees of the property of the New Haven, never were lessees of Old Colony, for "a lease, being property *cum onere*, does not pass to a trustee in bankruptcy unless he adopts it" (*Palmer* v. *Palmer*, *supra*, 104 F. (2d) 161, 163)[7] and this they have categorically refused to do (R., p. 66, fol. 198). The use they make of the terminal is in no sense a part of the operation of the property of the New Haven—a fact that would be evident to all had Old Colony and Boston and Providence taken over the operation of their own properties instead of leaving them to be operated for their account by petitioners under the requirements of Sec. 77(c)(6). And the inability of those Companies to take possession of their lines and operate them should not falsify the relations between the roads themselves or disguise the result (*Palmer* v. *Warren*, *supra*, 108 F. (2d) 164, affirmed, *Warren* v. *Palmer*, *supra*, 310 U. S. 132).

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[7] The rule is the same in receivership. *Quincy M. P. R. Co.* v. *Humphreys*, 145 U. S. 82 [1892]; *St. Joseph & St. L. R. Co.* v. *Humphreys*, 145 U. S. 105 [1892]; *U. S. Trust Co.* v. *Wabash Western Ry.*, 150 U. S. 287 [1893]; *Penn. Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 728, 729, 731, C. C. A. 2d, 1912.

Under the Act of 1896 mere use of the terminal by petitioners in behalf of Old Colony and Boston and Providence under the Act of 1896 of course obligates the estates of the two former lessors to pay the price fixed for that use. No one denies this, as the court below has pointed out. But we do deny any liability of the New Haven estate to the Terminal Company under the Act of 1896 on account of operations required to be conducted by petitioners for other estates. The relationship between petitioners and these other estates is not even as close as that of an operating agent to his principal. If petitioners are agents for anyone, they are agents for the court (Opinion below, R., p. 193, fol. 578), not the parties (*Quincy M. P. R. Co.* v. *Humphreys, supra*, 145 U. S. 82; *Union Trust Co.* v. *Ill. Midland R. Co.*, 117 U. S. 434 [1886]; *Penn. Steel Co.* v. *New York City Ry. Co., supra*, 198 Fed. 721, 728; *Westinghouse Elec. & Mfg. Co.* v. *B. R. T. Co.*, 6 F. (2d) 547, 550, C. C. A. 2d, 1925). As to Old Colony and Boston and Providence lines, petitioners are merely the operators under orders of the reorganization court. But even if they were more than this—if they were known agents of the former lessors and operating the properties as such agents—they would not be liable for the debts to third persons incurred in the operation of their principals' business (*Feldman* v. *American Palestine Line*, 18 F. (2d) 749, 750, C. C. A. 2d, 1927; 1 Mechem on Agency, 999, sec. 1357; 3 C. J. S. 119, sec. 215). Unlike the known agent they are receiving no benefit from terminal operations as the segregation so clearly shows. In fact it is costing them large sums of money, the recollection of which has become very doubtful. If voluntary agency does not make for liability under these circumstances, surely a more remote and involuntary relationship should not do so.

(2) *Sec. 124a, whether considered alone or in conjunction with Sec. 77(c)(6), does not make cash in the New Haven estate available for the discharge of liabilities of Old Colony and Boston and Providence estates to the Terminal Company for the latter's taxes, the payment of which is not immediately necessary to continued operation of lines of the former lessors.*

A. Introductory.

Thus we have seen that no Massachusetts statute makes the New Haven estate liable here. Accordingly, any liability must rest on the basis of Federal law. The question arises whether any Federal statute produces that effect.

The Circuit Court of Appeals expressly placed its opinion squarely upon Sec. 124a. We are therefore presented with a direct question of statutory interpretation and must look carefully both at the language of Sec. 124a, taken in connection with Sec. 77 of the Bankruptcy Act, and at the Congressional background of the passage of this Section.

B. Sec. 124a does not by its terms apply to the present situation.

The conclusion of the court below that cash in the New Haven bankrupt estate must be expropriated in payment of tax liabilities of others is rested squarely upon the requirement of Sec. 124a that:

> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall * * * be subject to all State and local taxes applicable to such business the same

as if such business were conducted by an individual or corporation * * *".

Since the taxes here involved are taxes on Old Colony business, and on that of its former lessor, the Boston and Providence, it becomes important to determine who it is that is "authorized by said court to conduct [that] business", and also out of what funds these taxes should be paid. Let us look at the situation presented.

Sec. 77(c)(2) provides that the trustees of a railroad in reorganization shall have the power to operate "the business of the debtor". Subsection (c) (4) further provides that the trustees so appointed shall file schedules and information to disclose "the conduct of the debtor's affairs".

Pursuant to these subsections of Sec. 77, Messrs. Palmer, Loomis and Sawyer were appointed by the District Court (R., pp. 85, 86) as "Trustees of the property of the Old Colony Railroad Company". They were given, in accordance with the terms of the above subsections, power to operate "the business of the Old Colony Railroad Company" (R., pp. 86, 87). Their ultimate responsibility is evidenced by the court's requirement of a bond from them *as Old Colony Trustees* (R., p. 86).

Accordingly it is Messrs. Palmer, Loomis and Sawyer *as Old Colony Trustees*, and as Old Colony Trustees alone, who are, in the words of Sec. 124a, "authorized by said court to conduct [the Old Colony] business" and who do conduct it.

Thus, paragraph 8 of the order appointing the Old Colony Trustees provides that the three above persons

> *"as Trustees of Old Colony Railroad Company* shall by this order have authority and power to

designate employees of Old Colony Railroad Company or of The New York, New Haven and Hartford Railroad Company to execute and deliver *in their stead* and as their agents checks, drafts, vouchers, orders, contracts and any or all instruments incidental to their duties and that such instruments, so executed by the agents of said Trustees shall bind said Trustees to the same extent as though their signatures respectively had been affixed thereto" (R., p. 91).

In sharp contrast to this responsibility of the *Trustees of the Old Colony* for the conduct of *its* business and the application of its funds, is the position of the *New Haven* Trustees,—who happen, for reasons of convenience approved by the Interstate Commerce Commission,[8] to be the same three individuals. Let us examine the relationship of the New Haven Trustees to the Old Colony property and business as it is defined in Sec. 77 and in the orders of the District Court.

Sec. 77(c)(6) provides that if a lease of a line of railroad is rejected, it shall be the duty of the lessor "to *operate* the said *line*", unless it shall be found impracticable for the lessor to do so, "in which event it shall be the duty of the lessee to continue *operation* on or *for the account* of the lessor * * *".

By Order of June 3, 1936, the Court approved the petition of Old Colony for reorganization under Sec.

[8] There is no requirement in Sec. 77 that the Trustees of a former lessor line in reorganization under Sec. 77 must be the same individuals as those who are Trustees of the property of the former lessee. Thus, in the reorganization of the Erie Railroad Company, different individuals were appointed trustees of the Northern Railroad of New Jersey, a line which bears exactly the same relationship to the Erie as the Old Colony does to the New Haven.

77; and, pursuant to request in the petition of Old Colony, said order provides that the Trustees of the New Haven estate should possess and "*operate* the [Old Colony's] *property*, such operation to be *for the account* of" the Old Colony. By the order appointing trustees of Old Colony, the court decreed that the New Haven Trustees should "*possess* and *operate* the properties of Old Colony Railroad Company such operation to be *for the account* of Old Colony Railroad Company or the Trustees of its property" (R., p. 87).

Thus, the provisions, both of Sec. 77 and of the Court's orders entered pursuant thereto, have made clear the distinction between the status and duty of the Trustees of the New Haven [former lessee] to "*operate* the [formerly leased] *line*" and that of the Old Colony Trustees, who "conduct the business of the debtor". (See Sec. 77, subdivisions (c)(2) and (c)(4).)

Accordingly, it is submitted that it is the Old Colony Trustees, and not the New Haven Trustees, who are "authorized by said Court to conduct [the] business" to which the State taxes referred to in Sec. 124a are applicable—*i.e.*, the Old Colony's business. It is they who must determine the basic policy to be followed as, for example, whether appropriate steps should be taken before the Court and Interstate Commerce Commission to abandon all or part of the operations in the interest of the Old Colony's estate and its ultimate reorganization. (Cf. Petition for Abandonment of Boston Group, I. C. C. Finance Docket No. 12614, in which the New Haven Trustees joined only as operators.)

Similarly as to the Boston and Providence business, in its order directing the Old Colony Trustees to

reject the Boston and Providence lease the District Court provided for continued operation by the New Haven Trustees of the property of Boston and Providence for the account of that corporation pursuant to subdivision (c)(6) of Sec. 77 "but without expense to the New Haven estate" (R., p. 112).

Shortly thereafter a creditor of the Boston and Providence filed a petition under Sec. 77 of the Bankruptcy Act for its reorganization in the District Court of the United States for the District of Massachusetts, alleging among other things the fact, essential to approval of such a petition (Sec. 77(a) and (m)), that the Boston and Providence "is a common carrier by railroad *engaged in* the transportation of persons and property in interstate commerce" (R., p. 126), and also alleging that the United States District Court for the District of Connecticut had ordered the operation of the property of the Boston and Providence to be continued by the New Haven Trustees for the account of the Boston and Providence (R., p. 125). These allegations were admitted by the Boston and Providence (R., p. 125) and the Massachusetts Court having been satisfied that the petition complied with Sec. 77 and had been filed in good faith approved it (R., p. 127) and provided for the appointment of Trustees of the property of the Boston and Providence (R., p. 128). Subsequently that court entered an order appointing Bentley W. Warren and Charles W. Mulcahy trustees of the property of the Boston and Providence. These appointees were confirmed by the Interstate Commerce Commission and on October 18, 1938 qualified by filing bonds and since that time have been acting as trustees. (*In the Matter of Boston and Providence Railroad Corporation*, No. 62413,

District Court of the United States, District of Massachusetts, Order of August 22, 1938.)

Accordingly, it is Messrs. Warren and Mulcahy, and not the petitioners, who are in the words of Sec. 124a "authorized by said court to conduct [the Boston and Providence] business" and who do conduct it.

The application of Sec. 124a to a situation like the present never occurred to anyone prior to the filing of the brief of the City of Boston as *amicus curiae* directly before the oral argument in the Circuit Court of Appeals. Petitioners objected to the filing of this brief and were never given an opportunity to answer it.

That Sec. 124a is inapplicable to a situation like the present, is indicated by the fact that in the only other comparable case which has been found, the Judge in handing down his opinion did not even consider it necessary to mention Sec. 124a. In the *Interborough* case, which was decided a year after the enactment of Sec. 124a and which is discussed more fully below, Circuit Judge Mack (sitting as a District Judge) refused to require the payment of taxes on a leased line out of the estate of the lessee.

C. Even if Sec. 124a should be held to apply to New Haven Trustees as operating Old Colony and Boston and Providence lines, it does not require that Old Colony and Boston and Providence taxes must be paid out of New Haven funds.

We admit that the words used clearly describe, and were intended to subject, Messrs. Palmer, Loomis and Sawyer as Trustees of the Old Colony (who, it must be clearly borne in mind, are not the petitioners here)

and Messrs. Warren and Mulcahy as Trustees of Boston and Providence to "all State and local taxes applicable to such [Old Colony and Boston and Providence] business"; and to require that those taxes be paid by such Trustees out of Old Colony and Boston and Providence funds respectively. Similarly, we admit that the words also clearly describe, and would be applicable to require Messrs. Palmer, Loomis and Sawyer, as New Haven Trustees (who are the petitioners here), to pay out of New Haven funds all State and local taxes applicable to the New Haven's business. But no taxes applicable to the New Haven's own business are involved here. The Circuit Court of Appeals has interpreted the statute so as to require the *New Haven* Trustees to pay, out of assets held by them for *New Haven* creditors, taxes applicable to *Old Colony* and *Boston and Providence* business.

But even if Sec. 124a should be held to apply to New Haven Trustees as operating Old Colony and Boston and Providence lines, *it does not follow from anything in that statute that petitioners must take the property of a separate estate of which they also happen to be trustees and use it to discharge the liabilities of the estates of the former lessors whose cash and credit are insufficient to meet their own obligations.*

It is to be noted that Sec. 124a does not provide that the taxes of the business carried on shall be paid out of the separate assets of the trustee or agent so authorized by the court. The most that can be said by the respondents is that the statute is silent as to the source from which the funds are to be obtained to pay the taxes. This silence, it is submitted, was perfectly natural. Congress hardly thought it necessary to say that the taxes applicable to a business should be paid by that business, and not by somebody else.

If, on the other hand, the intention had been to create a novel principle of taxation requiring payment to be made from the separate estate of the operating trustee, an express provision to this effect would certainly have been included. Not only is there no such provision, but Sec. 124a clearly indicates that no such result was to be achieved. On the contrary, it makes provision for taxes applicable to the business "the same as if such business were conducted by an individual or corporation * * *".

The Circuit Court of Appeals, after the citation of Sec. 124a in the *amicus curiae* brief, immediately jumped to the conclusion that the taxes must be paid out of any property found in petitioners' hands even if such property was held in trust by them for others and was no more subject by State law to the payment of the taxes than are petitioners' own private dwellings and bank accounts.

The holding of the court below was not based upon any failure to distinguish between the various properties and estates being operated by petitioners. It knew, and indeed pointed out, that the Old Colony system (including Boston and Providence property) was producing an enormous deficit in excess of $20,000,000 which had been met from New Haven funds (R., p. 187, fol. 560), that the tax liabilities were those of Old Colony and Boston and Providence estates (R., p. 193, fol. 579) and that their payment out of trust funds in the New Haven estate would further jeopardize the claims of the New Haven's own secured creditors who since the inception of the New Haven reorganization proceedings had been sustaining a loss, not a benefit, from Old Colony system operations (R., p. 187, fols. 559, 560). In so holding the court below failed even to cite its earlier opinion, *Dulberg* v.

Zankel, 67 F. (2d) 534, 537, C. C. A. 2, 1933, handed down it is true before Sec. 124a was passed, but announcing a general rule, said to be "self-evident", that deficits from the operation of unprofitable property in a receiver's hands should not be met from the earnings of other property also operated by the receiver. The court there said:

> "Assuming that current taxes assessed against [the unprofitable] property of Nestwood Estates, Inc. would be entitled to priority over creditors of its receiver in the distribution of property *belonging to it*, it must appear that property of *that corporation* is in the receiver's hands for distribution before any such question of priority can arise. * * *
>
> "The receivership embraced property of several distinct corporations. Although one receiver was appointed for all, he held the property of each as a trust estate for the benefit of its own creditors and shareholders."

The decision of Judge Mack in the receivership of the Interborough Rapid Transit Company, filed May 29, 1935, is highly apposite here not only because it was decided a year after Sec. 124a was enacted but also because of the similarity of the circumstances there involved. In that case the City of New York claimed that the court should require the payment out of the Interborough estate, of City taxes on the Manhattan Elevated Lines, which had been leased to the Interborough long prior to the receivership of the two companies. The Court said (Vol. VII, Interborough Rapid Transit Company-Manhattan Railway Company Printed Receivership Record, p. 6237):

> "Insofar as the City asks immediate payment by the Interborough Receiver of all past due

Manhattan taxes, the petition must likewise be denied. The earnings of Manhattan Railway Company's lines presently in the hands of the Interborough Receiver are apparently at least less in amount than the overdue Manhattan taxes. Until the question of affirmance or disaffirmance of the lease is decided, the City clearly has no right to demand that *Interborough* funds be used to discharge liens on *Manhattan* property. Cf. *Dulberg* v. *Zankel*, 67 F. (2d) 534 (C. C. A. 2d, 1933). As an appeal to the exercise of the Court's discretion, the application will not be granted at this time."

It is to be noted that the court refused to require the Interborough estate to pay taxes of the Manhattan, even though the Interborough receivers had not then disaffirmed the lease of the Manhattan lines. It is implicit in the above opinion that, if the lease of the Manhattan had already been disaffirmed by the Interborough, funds of the Interborough estate could not have been required to pay Manhattan taxes; otherwise the court's opinion has no meaning. *A fortiori* in the instant case, where the lease of the Old Colony properties was disaffirmed by the New Haven Trustees in 1936 and where prior taxes and operating charges in behalf of the Old Colony and Boston and Providence have been advanced by the New Haven estate to the extent of some $20,000,000, the New Haven estate should not be required to advance further funds for the Old Colony's and Boston and Providence's accounts. It is respectfully submitted that the decision of the District Court not to require, under all the circumstances, further advances by the New Haven estate to pay Old Colony and Boston and Providence taxes, did not constitute an abuse of that court's discretion.

The correct approach is that in the decision in *In re Reorganization of Pittsburgh Rys. Co.*, 111 F. (2d) 932, C. C. A. 3, 1940. The first thing the Circuit Court of Appeals for the Third Circuit did there was to determine whether or not the debtor's estate was liable for the taxes due the State from the underlying companies whose properties were being operated under the so-called net earnings rule as parts of the debtor's railway system;[9] and having found that the debtor's estate was not liable for the taxes, the Appellate Court concluded that the debtor's trustees should not pay them from the debtor's estate. However, it is to be noted that in the *Pittsburgh Rys.* case the lease had not been disaffirmed. It ultimately may turn out that operation is for the lessee's own account, which could not be so here.

Sec. 124a does not in terms reach out beyond the particular business the trustee or agent is conducting —in this case the business of Old Colony and Boston and Providence. It subjects *that business* in the hands of the trustee or agent to the burdens of State taxation "the same as if such business were conducted by an individual or a corporation". If the Old Colony Trustees as such and the Boston and Providence Trustees were operating the lines as well as conducting the general business of the Old Colony and Boston and Providence companies—as it is their duty under Sec. 77(c)(6) to do, if practicable—Sec.

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[9] We refer the Court to subdivisions 1(b) and (c) pages 5, *et seq.* of our brief in reply to the brief of respondent opposing our petition for the following propositions: (1) The *Pittsburgh Railways* case is a case decided under Sec. 124a; (2) It is also a case decided under the receivership rule that the receiver of the lessee's property shall operate "for the account of the lessor", which rule was incorporated into Sec. 77(c)(6).

124a would require them to pay the taxes of that system, and no one would suggest the existence of any duty of New Haven Trustees to do so. Furthermore if, in spite of the necessity of looking to the New Haven estate for physical operation, the Old Colony or Boston and Providence Trustees had sufficient funds in their respective estates, they would have to pay the instant taxes therefrom—either directly or, for convenience, through the New Haven Trustees. The purely fortuitous circumstances (i) that petitioners are operating the Old Colony and Boston and Providence lines under Sec. 77(c)(6), due to the fact that the Old Colony and Boston and Providence estates do not have the equipment physically to operate their own property, and (ii) that the Old Colony and Boston and Providence estates do not have sufficient funds for the payment of their own taxes, do not enlarge beyond the requirements of State law the fund out of which the Old Colony and Boston and Providence taxes would ordinarily be payable under that law.[10]

As has been seen above, the State law did not even try to impose a tax burden upon the New Haven except in its former capacity of "lessee" of the terminal. That the Circuit Court of Appeals rested its decision squarely on Sec. 124a, wholly apart from the provisions of Massachusetts law (thus admitting that thereby it might be enlarging the scope of State law) is well illustrated by the statement at the end of its opinion (R., p. 196) that

> "In the view which we have taken of the case, it is not necessary for us to decide whether the

[10] Ultimate payment of the taxes to the State is, of course, assured through the lien accruing upon the property against which the tax is laid (G. L. Mass., Ch. 60, Sec. 37).

provisions of the Massachusetts Act of 1896, imposing direct obligations on the New Haven, 'being lessee' of the Old Colony, continue to bind the New Haven after it had rejected the lease."

D. THE BACKGROUND OF SEC. 124a ALSO SHOWS CLEARLY THAT CONGRESS HAD IN MIND A SITUATION TOTALLY DIFFERENT FROM THE PRESENT ONE AND DID NOT INTEND TO FORCE THE PAYMENT OF THE TAXES OF ONE ESTATE OUT OF THE FUNDS OF ANOTHER.

Fortunately, both the House and Senate Judiciary Committees filed clear, concise reports with respect to why Sec. 124a should be passed. The Senate Report (73d Congress, 2d Session, Report of Committee on the Judiciary, No. 1372) embodies verbatim the House Report, except for an unimportant amendment. Accordingly, it is necessary to consider here only the House Report.

The House Report (73d Congress, 2d Session, Report of the Committee on the Judiciary, Report No. 1138), with the exception of the formal introductory paragraph, is as follows:

> "The purpose of this bill is to subject businesses conducted under receivership in Federal court to State and local taxation the same as if such businesses were being conducted by private individuals or corporations.
>
> The United States District Court for the Western District of Missouri in the case of *Howe v. Atlantic, Pacific & Gulf Oil Co., et al. (State of Missouri, et al., Intervenors)*, (4 Fed. Supp. 162), recently held that a receiver operating a gasoline-and-oil distributing business under appointment by the Federal court was not liable

for a sales tax on motor fuel levied by the State of Missouri. As a consequence of this decision, your committee is advised, the State of Missouri and other States having similar statutes are losing thousands of dollars of revenue per month.

No good reason is perceived why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the States and local governments be deprived of this revenue."

The only debate on this bill took place in the House and is to be found at page 6656 of the Congressional Record for the 73d Congress, 2d Session. The debate is only a few paragraphs long and the only material part of it is as follows:

"Mr. McKeown: A great many receivers in oil cases have been held by the court not liable to pay taxes. They do not pay the gasoline taxes to the State. * * * [One sentence paraphrasing above] * * * In the receivers for bank cases (sic) they do not have to pay the taxes to the State."

It is accordingly perfectly clear that both the House and the Senate had in mind the situation raised by the *Howe* case in passing this statute. In the *Howe* case (reversed later—70 F. (2d) 360) the Federal Court in Missouri held that a receiver of a gasoline company was not subject to a sales tax on gasoline, even though the Company itself would have been subject to the tax if it, instead of the receiver, had continued to conduct the business. Congress accordingly enacted Sec. 124a for the purpose, as stated in the above report, of being sure to subject "businesses conducted in a receivership" to local taxation "the same as if such businesses were being conducted by private individuals or corporations".

The purpose of Sec. 124a is "to facilitate—not to obstruct—the enforcement of State laws" (*Boteler* v. *Ingels*, 308 U. S. 57 [1939]); and recent typical cases illustrate its application to *the particular property or business upon which the tax is laid* (*Boteler* v. *Ingels*, *supra*; *Ingels* v. *Boteler*, 100 F. (2d) 915, 919, 920, C. C. A. 9, 1938; *Board of Directors of St. Francis Levee District* v. *Kurn*, 98 F. (2d) 394, 397, C. C. A. 8, 1938, cert. den., 305 U. S. 647 [1938]).

That this was the purpose of Sec. 124a is shown not only by the Congressional Report and debate, but also by many court decisions, of which that of the Circuit Court of Appeals for the Eighth Circuit in *Thompson* v. *Louisiana* contains perhaps the fullest discussion (98 Fed. 108—1938). In that case the Court referred to the holding in *United States* v. *Whitridge*, 231 U. S. 144 [1913], that the federal corporation tax law imposing an excise tax on the doing of business by corporations, was not applicable to a receiver of a corporation appointed in a state court; that the receiver was not liable for corporation taxes subsequent to his appointment, since he operated the property as an officer of the court and not as an officer of the corporation. The Circuit Court of Appeals also referred to the opinion in *Hagerty* v. *Michigan Trust Company*, 286 U. S. 334 [1932], in which Mr. Justice Cardozo, speaking of a Michigan statute imposing a tax upon a corporation for the privilege of exercising its franchise and of transacting business, said:

> "Whether a corporation does exercise its franchise or transacts its business within the meaning of a statute so framed when it does business through a receiver is the subject on which much

subtle argument has been expended by State and Federal courts."

After referring to other cases in which such distinctions had been attempted, and in some recognized, the Circuit Court of Appeals said:

> "As has been observed, before the passage of Sec. 124a, there had been holdings to the effect that a receiver conducting the business of a corporation was not liable for the franchise tax, and there have been holdings that such a receiver should be liable for such a tax. The courts had also held that the trustee in bankruptcy should not be held so liable because he was vested not only with the title but possession of the property, and hence, the corporation was not doing any business. * * *
>
> "There was more or less doubt and uncertainty as to whether, or under what conditions, receivers, liquidators, referees, trustee, or other officers appointed by Federal courts to conduct any business should be liable for local taxes applicable to the business conducted. In this state of affairs, Congress passed Section 124a, for the manifest purpose of putting at rest all doubt and uncertainty in this regard" (p. 111).

The requirement that one estate should pay the taxes assessed against another estate would be a novel principle of taxation. We have now examined the background of the passage of Sec. 124a and have seen that Congress never in any way considered such a principle in passing Sec. 124a. It would be inconceivable that Congress should inaugurate such a principle without even mentioning it or considering it. Therefore, we may conclude that, *since Congress had a purpose other than the one claimed by respondents*

in passing Sec. 124a; since it made no mention whatsoever of this claimed novel purpose in passing this Section; and since the purpose now claimed for it would be a wholly new principle of taxation, this Court would be unwarranted in so construing this Section as to make one trust or receivership estate liable for the taxes of another estate.

(3) Sec. 124, whether considered alone or in conjunction with Sec. 77(c)(6), does not make cash in the New Haven estate available for the discharge of indebtedness of Old Colony and Boston and Providence estates to the Terminal Company for the latter's bond interest, the payment of which is not immediately necessary to continued operation of the lines of the former lessors.

A. Introductory.

So much for the question of the statutory requirement to pay taxes. The question whether the New Haven estate is required to advance cash for the payment of interest on the Boston Terminal Company bonds for which the Old Colony and Boston and Providence corporations were obligated, is a wholly distinct question. As the Circuit Court of Appeals pointed out, the answer to that question must begin with a consideration of Sec. 124. While the section enacted in respect of taxes was designated Sec. 124a, it was, as we have seen above, passed in 1934, forty-seven years after the enactment of Sec. 124. Moreover, as we have seen, Congress did not refer to Sec. 124 in passing 124a. It was probably placed next to Sec. 124 in the United States Code only because both sections deal with federal receivers and trustees.

In addition to the fact that Sec. 124a relates only to taxes, it is important to note the fundamental difference in the provisions of the two sections. Sec. 124 reads in part as follows:

> "Whenever in any cause pending in any court of the United States there shall be a receiver or manager *in possession* of any property, such receiver or manager *shall manage and operate such property* according to the requirements of the valid laws of the state in which such property shall be situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

From the first clause of this section it is clear that —unlike Sec. 124a, which describes only receivers or trustees who "conduct [the] business"—Sec. 124 does describe the New Haven Trustees here, for they do "operate [the Old Colony's and Boston and Providence's] property". This section, it is seen, not only begins by being applicable to those receivers who carry on the physical operation of the property, but the whole section is devoted to *physical operation* of the property—to assure that in such physical operation the requirements of valid State law shall be complied with.

B. THE REQUIREMENT OF SEC. 124 RELATES TO PHYSICAL OPERATION OF THE PROPERTIES OF OLD COLONY AND BOSTON AND PROVIDENCE, NOT TO THE PAYMENT OF INTEREST ON BONDS FOR WHICH THOSE COMPANIES ARE LIABLE.

Sec. 124 differs from Sec. 124a in that it is concerned with the physical operation of property by court officers, not payment of corporate indebtedness.

Accordingly this Court has held that a federal receiver or trustee is bound by valid State laws relating to the operation of trains at a specified speed (*Erb* v. *Morsch*, 177 U. S. 584 [1900]), the abandonment of railroad service (*Palmer* v. *Massachusetts*, 308 U. S. 79 [1939]), and the giving of a bond to observe the requirements of State laws as to operation, including a bond for taxes (*Gillis* v. *California*, 293 U. S. 62 [1934]). Compliance with the State law under these decisions required the receiver or trustee to lay out more in cash than non-compliance would have, but this was because Sec. 124 required him to operate in a certain way. However, this merely shows that occasionally payment has been a by-product of the statute,—not that payment is its goal. After all, the stated statutory obligation is to "manage and operate". And, significantly, when the court officer paid the increased expense of compliance with State law, under the decisions just cited, he was not paying principal or interest on a debt previously incurred by a debtor corporation before the receivership began.

State law, of course, always requires a debtor to pay his debts. If this section, which is directed toward assuring compliance with State laws as to the operation of properties, should be held to have the same meaning as that given by the Circuit Court of Appeals, it would require that every receiver who actually operates a property of an insolvent corporation would have to find and advance cash to pay all the debts of such corporation. The inequity of such a result would be all the more striking here, where the New Haven trustees are being required to operate the properties of Old Colony and Boston and Providence under compulsion of Sec. 77(c)(6), since those companies themselves are physically unable to operate their own property.

The long forbearance of the New Haven estate and its creditors in advancing New Haven funds in connection with the operation (and in some cases even where not necessary to physical operation) of the Old Colony properties is evidenced by the fact that the amount of such advances during the last four years total some $20,000,000. As the Circuit Court of Appeals pointed out, the Old Colony property no longer affords the New Haven estate "a sufficient security to warrant the diversion of additional funds, without jeopardy to the claims of the New Haven's own secured creditors" (R., p. 187).

The New Haven Trustees must, however great the desire to continue physical operation, bear in mind that the assets of the New Haven estate are held for the payment not only of the New Haven creditors but also of the debts which they as New Haven Trustees have incurred. Their debts as New Haven Trustees must be paid before reorganization can be accomplished. But, if, as the court below would have them do, they continue paying debts previously incurred, not even by the New Haven, but by the Old Colony and the Boston and Providence, no fair reorganization would be possible.

Even if the court below was correct in its conclusion that under Sec. 77(*c*)(6) "the burden of operating, come what may, survives rejection" and "even if the *indispensable* costs of operation result in a net loss, that loss must be met, if necessary, out of the funds of the lessee" (R., p. 190, fol. 570), that conclusion has utterly no bearing on the present controversy. As the Court has found, neither the payment of taxes nor of interest is indispensable to operation (R., p. 192, fol. 575). Petitioners are paying currently all expenses necessary to operation into the terminal (R., p. 10, pars. 7, 8; p. 192, fol. 574) and

such operations are in fact continuing despite petitioners' continued compliance with the order of the District Court here in issue. Every stated requirement of Sec. 77(c)(6) is being met. As the District Court pointed out, "operation" is the only mandatory duty the subdivision imposes on a lessee's trustee. Surely it cannot be stretched to include a requirement that the trustee must make payments for the lessor which are not necessary to the operation the subdivision requires.

C. THE INTERPRETATION OF SEC. 124 MADE BY THE COURT BELOW CREATES A PREFERENCE IN FAVOR OF BONDHOLDERS OF THE BOSTON TERMINAL—A WHOLLY SEPARATE ESTATE—OVER THE SECURED CREDITORS OF THE NEW HAVEN WHO HAVE A FIRST LIEN ON THE FUNDS INVOLVED.

The Boston Terminal bondholders have a claim against the Boston Terminal Company secured by the terminal properties. They may have an unsecured claim against the Old Colony and Boston and Providence which has no great value in view of the insolvency of these companies. They have no claim against the New Haven estate at all. In spite of this, the Circuit Court of Appeals' decision has the effect of giving these bondholders a prior claim—worth immediate cash—against the New Haven estate in priority to the secured bondholders of the New Haven.

Bonds issued to pay for the cost of construction of a railroad terminal obtain no prerogative rights or extension of stated security from the mere fact that the State, in the exercise of its police power provided for the terminal to be built and paid for by a bond

issue. The bonds are not thereby insulated from the consequences of bankruptcy or insolvency. They wear no halo, but are mere evidences of indebtedness entitled, to the extent they are unsecured, to share equally in the estate of a bankrupt obligor. Even under the assumption, made solely for purposes of this particular argument, that the New Haven is now liable for the bond interest, no property, real or personal in the New Haven estate is described or identified as security for the payment of the principal of or interest upon the bonds, which are a lien only on property of the Terminal Company (see *North Kansas City Bridge & R. Co.* v. *Leness*, 82 F. (2d) 9, 13; C. C. A. 8, 1936). At most, the New Haven's hypothetical indebtedness for interest would make the Terminal Company a general creditor of the New Haven, holding a common claim against it under Sec. 77(b).[11]

The New Haven's own bondholders, who are secured by mortgage on New Haven property, and the holders of obligations guaranteed by the New Haven are still waiting for payment of interest (R., p. 13, fol. 38) due by the "valid laws" of all the States in which the New Haven lines are operated. It is in bankruptcy. That being the case, unless sufficient property is available therefor, the New Haven's general creditors will get no interest whatsoever on their claims. One of the evident purposes of the Bank-

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[11] "The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act", . . . and

"The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character."

ruptcy Act is to prevent preference and provide for a fair distribution of the assets of a debtor. This is of course true of the reorganization sections of the Act, even though the property distributed under the plan is usually in the form of securities of a new corporation rather than in property of the debtor. Even if the Massachusetts Act of 1896 had required the New Haven to guarantee for all time the punctual performance of the Terminal Company obligation upon its bonds, the guarantee would now be no more enforceable specifically than other general claims against the New Haven. To pay the interest after the bankruptcy proceedings began would be to prefer Terminal Company bondholders over both secured and common creditors of the New Haven and interfere directly "with the [exercise of] federal equity and bankruptcy powers upon which the reorganization of railroads is based". (Cf. Opinion below, R., p. 195, fol. 584).

Sec. 124 announces no purpose to interfere with the fair distribution of insolvent estates; and there is no reason for implying one. The statute deemed controlling by the lower court simply has no bearing on the matter of present payment of general or secured claims in bankruptcy though payment be admittedly due under valid State laws. The discharge of a debtor's obligations is left to the Bankruptcy Act itself, and it forbids preferences.

Sec. 77(c)(6) adds nothing to Sec. 124 in this connection. By no stretch of the imagination could the payment of a general claim for bond interest be deemed necessary to continued operation of the property of the former lessors. The court below did not so find. Indeed it found that such payment was not necessary, but none the less ordered it. We submit that neither Sec. 124, nor Sec. 77(c)(6), nor both

together were intended to bring about the result sanctioned by the Circuit Court of Appeals.

(4) *The interpretation made by the court below of Secs. 124 and 124a taken in connection with Sec. 77(c)(6) violates the due process clause of the Fifth Amendment to the Constitution of the United States.*

It should be understood at the outset that our only claim here is that the statutes are unconstitutional *as construed and applied by the Circuit Court of Appeals*,—not that they are unconstitutional in and of themselves. Accordingly, the following argument is useful primarily because it shows that the statutes cannot mean what the court below said they mean, for if they do collision with the due process clause would be immediate and fatal.

Taking the record as we find it, there is no need here to consider whether or not the Fifth Amendment would be violated by Congressional legislation requiring the New Haven estate to pay such *necessary* expenses of operation of Old Colony and Boston and Providence estates as *could ultimately be recovered* out of their properties. Although such a question would merit the attention of this Court, the present record presents a question even more serious. In this case the court below so construed and applied Secs. 124a and 124 in conjunction with Sec. 77(c)(6), as to require the New Haven estate to pay even the expenses of Old Colony and Boston and Providence that are *not necessary* to their continued operation and *cannot be recovered* from the operated properties.

In making provision for continued operation through Sec. 77(c)(6) Congress exercised powers granted to it by the Constitution to regulate com-

merce among the several States (Article I, Section 8, Clause 3) and to establish uniform laws on the subject of bankruptcies (Article I, Section 8, Clause 4). *Warren* v. *Palmer, supra* (310 U. S. 132); see also *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific R. Co.*, 294 U. S. 648, 671, 672 (1935). But these powers, like other great substantive powers of Congress, are subject in their exercise to the Fifth Amendment which forbids Congress to deprive any person of life, liberty or property without due process of law or to take private property for public use without just compensation (*Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 589 (1935); *Monongahela Navigation Co.* v. *United States*, 148 U. S. 312, 336 (1893); *Kuehner* v. *Irving Trust Co.*, 299 U. S. 445, 451 (1937); *Railroad Retirement Board* v. *Alton R. Co.*, 295 U. S. 330, 347 (1935); *Chicago, Rock Island & Pacific R. Co.* v. *United States*, 284 U. S. 80, 96, 97 (1931)).

Decisions of this Court have placed beyond question the test it will apply in determining the validity of legislation in this connection. The requirement is:

> "that the law shall not be unreasonable, arbitrary or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained."

Nebbia v. *New York*, 291 U. S. 502, 525 (1934);
Railroad Retirement Board v. *Alton R. Co.*, *supra*, 295 U. S. 330, 348, Note 5;
Heiner v. *Donnan*, 285 U. S. 312, 326 (1932);
Chicago, Rock Island & Pacific R. Co. v. *United States*, *supra*, 284 U. S. 80, 96, 97;

Great Northern R. Co. v. *Washington*, 300 U. S. 154, 160 (1937);
Nashville, C. & St. L. Ry. v. *Walters*, 294 U. S. 405, 429 (1935);
Chicago, M., St. P. & O. R. Co. v. *Holmberg*, 282 U. S. 162, 167 (1930);
Liggett Co. v. *Baldridge*, 278 U. S. 105 (1928).[12]

In the present case "the object sought to be attained" by Sec. 124 and by Sec. 77(c)(6) is continued operation of Old Colony and Boston and Providence properties into the terminal during reorganization proceedings, and the "object sought to be attained" by Sec. 124a is to subject to taxes *the business conducted for and the property of those companies* during such proceedings. The "means selected" by the legislation, as construed by the court below, were the payment of current Terminal Company taxes and bond interest out of another estate, although such payment was found not to be immediately necessary to continued operation. There is no relation, "real and substantial" or otherwise, between continuance of operation and the payment of charges not necessary to that operation; and if there were such a relation there is no reason in fairness why the New Haven estate should be called upon to discharge the debts of others by advancing cash that cannot be recovered.

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[12] The same test is applied to the several states under the Fourteenth Amendment (*Nebbia* v. *New York*, *supra*, 291 U. S. 502, 525; *Heiner* v. *Donnan*, *supra*, 285 U. S. 312, 326). Since this Court cites cases interchangeably under both amendments (*Railroad Retirement Board* v. *Alton R. Co.*, *supra*; *Heiner* v. *Donnan*, *supra*) we do likewise herein.

It may once have been true in a sense that the New Haven and the Old Colony system were members of the same family,[13] but it is not due process for the legislature to add the property of a wife to that of her husband in computing the husband's tax assessment even if they reside together as members of a family (*Hoeper* v. *Tax Commission*, 284 U. S. 206, 215 [1931]). So here. And *a fortiori* it is not due process to expropriate property in the bankrupt New Haven estate for the payment of taxes and bond interest of the Terminal Company for which the Old Colony and Boston and Providence are liable, however desirable it may be, as a general proposition to assure their payment. (*In re Reorganization of Pittsburgh Ry. Co., supra*, 111 F. (2d) 932, 935).[14]

The Massachusetts Act of 1896 did not even try to make the taxes or bond interest operating expenses of the New Haven estate (and payable now as an expense of administration of that estate) after the lease has ended.[15] Moreover, it could not have done

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[13] The lease that bound them together has now been rejected.

[14] In that case the Circuit Court of Appeals for the Third Circuit pointed out that until proof of net earnings by each underlier was made, any order directing the reorganization trustees of the Debtor to pay the underliers' taxes "would have no factual basis and would, therefore be *arbitrary* and possibly *confiscatory*". In the present case there is not even a possibility of net earnings by the underliers. Instead, the record shows a *deficit* of more than $20,000,000 (R., p. 13, fol. 37; p. 37, fol. 109; and see R., pp. 97-107, 114-122, 144-153).

[15] Section 10 of the Act merely provided that the payment should be deemed a part of *said railroad companies'* operating expenses and the New Haven no longer comes within that language (see subdivision 1 hereof, *supra*).

so if it had tried, for to adapt this Court's language in the *Hoeper* case, *supra* (p. 215) to the present situation, that which is not in fact an operating expense of the New Haven estate cannot be made such by calling it an operating expense (see also *Heiner v. Donnan*, *supra*, 285 U. S. 312). Indeed the taxes and bond interest here are no more operating expenses of the New Haven estate than the income of the wife in the *Hoeper* case was income of the husband, no matter what the legislature may have called them. The New Haven corporation is not made liable by State law for the payment of these charges, and if it were, a general claim for terminal bond interest would be no more an operating expense of petitioners than any other general claim against the New Haven.

And even if the New Haven Company were liable for the bond interest, the direction of the court below that petitioners pay it in full from assets belonging to New Haven creditors could be justified under the Fifth Amendment only if the liability were fully secured by property in the New Haven estate (*Doty v. Love*, 295 U. S. 64, 74 [1935]). As a matter of fact the bonds are a lien only on Terminal Company property and there is no property whatsoever in the New Haven estate upon which they are legally or equitably a charge.

The court below sought to justify the result of its decision by stating that petitioners could relieve themselves of the charges for the taxes and bond interest by seeking and obtaining permission from appropriate authorities to abandon all or a part of the operation into the terminal (R., p. 191, fols. 572, 573). This suggestion can perhaps be disposed of merely by pointing out that it boils down to a holding that

corporate debts petitioners do not owe must nevertheless be paid by them so long as they are required by Sec. 77(c)(6) to operate property of the bankrupt corporations that do owe them. But the issue here is not whether there shall be payment or abandonment. Instead it is: Must petitioners advance cash out of the New Haven estate for the payment of charges not necessary to operation?

Indeed it is difficult to believe that any appropriate federal or State authority would find that public convenience and necessity permitted abandonment of the terminal merely because charges for interest on its bonds are out of proportion to the business transacted. To do so would be to burn the ship merely to get rid of the rats. The obvious remedy here is reorganization of the Terminal Company, not abandonment of its property. This process, as noted, has already been initiated.[16] And where a middle course (reorganization) is feasible, neither the constitutionality of statutes nor departure from their plain meaning can be justified by suggesting an impracticable alternative. Yet the court below did just this. And in so doing it at least gave rise to a possibility that payment of the charges would place the Terminal Company in a position to obtain a dismissal of its reorganization proceedings whether or not it is in fact overcapitalized.

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[16] A plan was filed for the Terminal Company with the Interstate Commerce Commission by the Old Colony Trustees on May 3, 1940 but its consideration has been held up pending the outcome of this case. *In the Matter of The Boston Terminal Company, Debtor*, I. C. C. Finance Docket No. 12625.

(5) *The public interest is not involved here since continued operation of the property is not threatened and since the Commonwealth is not deprived of its right to payment of the taxes.*

The Circuit Court of Appeals relied heavily upon *Palmer* v. *Massachusetts, supra,* 308 U. S. 79, in the course of its abandonment argument but that decision does not touch the present problem. It merely holds that a reorganization court may not authorize abandonment of operation (as distinguished from non-payment of debts) when the Interstate Commerce Commission and the State authority have not acted within their respective fields. Here there has been no abandonment of operation. As the courts below found, the continued operation of the properties of the Old Colony, the Boston and Providence and the Boston Terminal Company in the public interest is in no way threatened either by the tax or interest disputes. The Circuit Court of Appeals confused with this public interest the present issue which is one solely between conflicting private interests, the security holders of the Terminal Company on the one hand and those of the New Haven estate on the other. By entering its order here in question the District Court did not deprive the Commonwealth of Massachusetts of any right. The Commonwealth in addition to having a lien on the property still has all its right against those who owe the taxes, the Boston Terminal Company, the Old Colony and the Boston and Providence. The court's order merely refused to require the New Haven Trustees to make further advances to those parties for taxes not owed by the New Haven estate and which would have to be taken out of funds held solely for the benefit of New Haven

security holders; the order in no way changed the legal situation.

In the *Interborough* case referred to above, Judge Mack in refusing to require the Interborough estate to provide funds for the payment of Manhattan taxes showed that the priority of the tax lien on Manhattan property was conceded but that "priority in *ad interim* payment does not, however, follow therefrom". He continued (Vol. VII, Interborough Rapid Transit Co.-Manhattan Railway Co. Printed Receivership Record, p. 6237):

> "Ultimate payment of the taxes with interest and penalties is assured because the value of the property of the corporation vastly exceeds the amount of the tax claim."

The tax issue here comes down in substance to a question between the security holders of the New Haven on the one hand and the security holders of the Boston Terminal Company, Old Colony and Boston and Providence on the other. One representative of the latter group of security holders (the trustee of the mortgage securing the bonds of the Terminal Company being the sole appellant below) is seeking to force the former group to pay the tax burdens of the latter.

Similarly the question of bond interest payments is a private matter only, not involving the public interest. The Boston Terminal Company bondholders cannot prevent the physical operation of the Terminal Company property; they are relegated to the remedies in the Bankruptcy Act as is every other railroad bondholder. Like any other railroad bondholder they are entitled only to their fair share in the assets of

the estate against which they have a claim. They are not entitled to require payment out of the assets of another estate also undergoing reorganization prior to the secured creditors of that estate.

CONCLUSION.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed and that Order No. 398 of the District Court should be affirmed.

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APPENDIX.

Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a):

"Sec. 124a. STATE TAXATION; BUSINESS CONDUCTED BY RECEIVERS, TRUSTEES OR OTHER COURT OFFICERS SUBJECT TO

Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: *Provided, however,* That nothing in this section contained shall be construed to prohibit or prejudice the collection of any such taxes which accrued prior to June 18, 1934, in the event that the United States court having final jurisdiction of the subject matter under existing law should adjudge and decide that the imposition of such taxes was a valid exercise of the taxing power by the State or States, or by the civil subdivisions of the State or States imposing the same."

Section 65 of the Judicial Code (28 U. S. C. A., Sec. 124):

"Sec. 124. (Judicial Code, section 65.) MANAGEMENT OF PROPERTY BY RECEIVERS. Whenever in any cause pending in any court of the United States there shall be a receiver or manager in possession of any property, such receiver or manager shall manage and operate such property according to the requirements of the valid laws of the state in which such property shall be situ-

ated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. Any receiver or manager who shall willfully violate any provision of this section shall be fined not more than $3,000, or imprisoned not more than one year or both."

Section 77(c)(6) of the Bankruptcy Act (11 U. S. C. A., Sec. 205(c)(6)):

"(6) If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of Title 49."

Massachusetts Acts and Resolves, 1896, Ch. 516:

"Sec. 2 [as amended by Acts 1921, Ch. 363]. The capital stock of said corporation shall be five hundred thousand dollars, and the Boston and Albany Railroad Company, its lessee, the New York Central Railroad Company, the New England Railroad Company, the Boston and Providence Railroad Corporation, the Old Colony Railroad Company, and the New York, New Haven and Hartford Railroad Company, being lessee of the Old Colony Railroad Company, may each subscribe for or purchase and hold one fifth

portion of the said capital stock. The corporation may by by-laws regulate the terms and conditions upon which its stock may be transferred. All said capital stock shall be paid in in cash by said railroad companies before the corporation takes any land under the provisions of this act."

"Sec. 9. All said railroad companies upon the completion of said station shall use the same, and the terminal facilities provided by said terminal company on the land herein-above authorized to be taken, for all of their terminal passenger business in Boston, instead of the passenger terminals now used by them, and the supreme judicial court, or any justice thereof, shall have jurisdiction in equity to enforce this provision; but said terminal company may contract with either of said railroad companies for the use of such separate and specified portion or portions of the terminal station hereinafter provided for, as may be reasonably necessary for their respective use."

"Sec. 10. Said railroad companies hereby required to use said union station shall pay to the terminal company for such use, in monthly payments, such amounts as may be necessary to pay the expenses of its corporate administration and of the maintenance and operation of said station, and of the facilities connected therewith and owned by said terminal company, including insurance and all repairs, all taxes and assessments which may be required to be paid by said terminal company, the interest upon its bonds or other obligations issued under the provisions of this act as the same shall become payable, and a dividend, not to exceed four per cent, per annum upon its capital stock. Each of said railroad companies shall pay for such use of said station and facilities in the proportion in which it has

the use thereof, the same to be fixed by the written agreement of all of said railroad companies before the completion of said station; and in case they fail thus to agree, the board of railroad commissioners shall determine such proportions upon the application of said terminal company or of any of the railroad companies. Said proportions as thus fixed, either by agreement or by the decision of the board of railroad commissioners, may be revised and altered from time to time, either by the written agreement of all of the railroad companies at any time, or by the board of railroad commissioners upon like application, at intervals of not less than three years. The decisions of the board of railroad commissioners fixing said proportions of payments shall be final and binding upon all of said railroad companies, and the payments required to be made by them respectively to said terminal company either by such agreement or decisions shall be deemed a part of their operating expenses, and the supreme judicial court or any justice thereof shall have jurisdiction in equity to compel such payments to be made, either by mandatory injunction or by other suitable process."

"Sec. 25. The terminal company shall pay a franchise tax to the Commonwealth upon the true market value of its capital stock, without any deduction whatever, but its real estate required by this act to be used by said railroad companies shall be assessed to and the taxes thereon shall be paid by said railroad companies, and in the assessment of franchise taxes upon said railroad companies each of them shall be deemed to be the owner of said real estate in the proportion in which it then has the use thereof under this act."